No. 15600

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

BETTY FINNEY and EDWARD F. FINNEY,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' REPLY BRIEF

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INTRODUCTION

The Brief for Respondent repeats the recital of facts almost verbatim from the statement by the Tax Court (Resp. Br. pp. 4-13). The Brief then again repeats part of the same recital as the introductory portions of its argument relating to the three questions on appeal (Resp. Br. pp. 16-17; 22-24; 26-31). However:

(1) The statement of the evidence in the record dealing with the films "Strange Holiday" and "White Fury" contained in Petitioners' Opening Brief is not quarrelled with

(see "Detailed Statement of the Facts", Pet. Op. Br. pp. 34-37; 41-43); and,

(2) Similarly, the "Detailed Statement of the Facts" dealing with Andrew Stone Productions and the problem of capital gain in Petitioners' Opening Brief (Pet. Op. Br. pp. 7-10) is not asserted to be inaccurate in any detail, though Respondent vigorously does attack petitioners' argument that a sale of a partnership interest is shown thereby (Resp. Br. pp. 32-35).

We mention the above not as a preface to still another review of the evidence or statement of the findings of the Tax Court, but because we wish to emphasize that a question of law is here involved. Not a single one of the many authorities relied on by Petitioners in their Opening Brief is questioned anywhere in the Brief for the Respondent. Indeed, only one of the numerous cases cited by Petitioners is even mentioned in Respondent's Brief. This is Boehm v. Commissioner, 326 U.S. 167 (Resp. Br. pp. 18-19), on which Respondent relies to preclude effective review by this Court of the Tax Court's determination that Petitioner had not established his claimed losses for 1945.

As stated in our Opening Brief (p. 37), we are aware that the question of loss is primarily a factual one. The statement of this rule, however, does not operate automatically in an Appellate Court to require the imprimatur of affirmance.

In the final analysis the sufficiency of the evidence to support a purported finding of fact by any administrative or judicial body is nevertheless a question of law. A finding of fact made without any supporting evidence -- even a finding of fact that no loss was sustained in a particular year -- is not to be saved by incantation of the rule in the Boehm case. An appellant is entitled, nevertheless, to a consideration of his precise arguments on their merits and to a determination of whether the Tax Court's findings are supported by substantial evidence in the light of the whole record. 1/

In each of the following cases, each of which was cited in our Opening Brief, findings of fact that no loss was sustained in a particular year were reversed by the reviewing Courts:

Cahn v. Commissioner, 92 Fed. 2d 674 (9th Cir. 1937)

Rhodes v. Commissioner, 100 Fed. 2d 967 (6th Cir. 1939)

Niagara Share Corp. v. Commissioner, 82 Fed. 2d 208 (4th Cir. 1936)

1/ The Act of June 25, 1948, c. 646, §36, 62 Stat. 991 (§1141(a) of the 1939 Internal Revenue Code as amended, and now 26 U. S. C. A. 7482(a) of the 1954 Code) legislatively overrode the rule of Dobson v. Commissioner, 320 U. S. 489 (1944), which had operated automatically to affirm findings of the Tax Court. The Statute now provides in pertinent part: "The United States Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court ... in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; ... "

THE MOTION PICTURES "STRANGE HOLIDAY" AND "WHITE FURY" BECAME WORTHLESS IN 1945 AND PETITIONER WAS ENTITLED TO DEDUCT THESE LOSSES IN 1945

A. "Strange Holiday"

We must take issue with Respondent's statement that Petitioner did not testify that "Strange Holiday" became worthless upon cessation of hostilities and that the only evidence thereof was his "own vague self serving testimony" (Resp. Br. p. 21). At page 84 of the Transcript of Record is the following:

> "THE WITNESS: I believe it was 1943, your Honor, and we engaged Mr. Oboler to make certain changes so that the film would be qualified for general presentation in the theaters, and just about the time that -- we had had a couple of showings on it, and as your Honor knows, in the latter part of 1945, hostilities ceased and we then tried to sell the film, and submitted it to several different people, and all of them felt that because the war was over, and because of its particular theme, and the citizens of the United States had had four years of incessant war, that they had had plenty and they felt that there was absolutely no

chance to sell this film at all."

At pages 92, 93, 126 and 127 he also testified to the efforts made to obtain distribution of the film after the war, all without success. This testimony was specific and definite, naming names and stating facts. There is no contradictory evidence in the record thereto. We submit that it must be controlling here, especially as Petitioner's utter candor and truthfulness with the Court is apparent on every page of the Record.

We must also take issue with Respondent's assertion that Petitioner's testimony "also indicates that he had a continuing intention to exploit it ["Strange Holiday"] for profit if he could" (Resp. Br. p. 22). Petitioner testified categorically (R. pp. 122-125) that no attempts were made to sell the film in 1946 or 1947, "that we practically abandoned the picture in '45", that "I would say that no effort was made at all," and " ... when I wrote it off in 1945, I just took it as a dead loss and figured that was the end of it, ... "

Respondent also states: "If the value of the picture depended upon the public mood, as taxpayer seems to contend, that fact may well have been reflected in the low price for which he acquired it" (p. 21). The difficulty with this thought, however, is that the film was clearly worth something when it was acquired, and that Petitioner acquired the film in 1943, more than two years before the subsequent termination of hositilities rendered it worthless.

Finally, Respondent states, "The fact that he sold it for $2,100 in 1951 leaves little merit to his contention that it became valueless in 1945" (p. 22). Here, at least, we would have thought that Petitioners' authorities would be grappled with. But Respondent's Brief simply ignores Cahn v. Commissioner, 92 Fed. 2d 674 (9th Cir. 1937), and Rhodes v. Commissioner, 100 Fed. 2d 966 (6th Cir. 1939), which clearly hold that subsequent recovery does not prevent proof of loss in a prior year (Pet. Op. Br. p. 40). (The alleged "confidence" of the chance purchasers in 1951 of course is immaterial to the problem, especially as they bought the film as stock material, not as a picture itself. See R. 131.)

The Supreme Court has pithily stated, "The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal test." Lucas v. American Code Co., 280 U.S. 445, 449. Under this test, the taxpayer is not required to be "an incorrigible optimist". United States v. S. S. White Dental Co., 274 U.S. 398, 403, and cases cited Petitioners' Opening Brief, p. 38. A practical test on this record, which is the test Petitioner himself applied at the end of 1945, requires a finding that "Strange Holiday" became worthless in 1945. See cases cited above page 3. Rhodes v. Commissioner, 100 Fed. 2d 966 (6th Cir. 1939), is particularly apt. There the taxpayer purchased two parcels of land in 1925. Hurricanes in 1926 and 1927 and the

Florida depression rendered the parcels, in his opinion, worthless. As to the first parcel the Court stated:

> "After the second hurricane, the petitioner concluded the property was worthless as he could find no purchaser for it and refused to make further payments under his purchase contract, sought to abandon it and charged off of his books of accounts as a loss the sum of $15,762.50 which he had paid and deducted this amount as a loss from gross income in his income tax return for 1927."

In 1928, as the result of an unsolicited cash offer, he sold the first parcel for $1,000 or $1,100. He still had title to the other parcel in 1928, the purchase contract to which he had abandoned in 1927 and as to which he had taken a loss of $28,875.00 in 1927. The Tax Court denied the loss deductions. The Court of Appeals reversed. At page 970, the Court stated:

> "The small sum received by petitioner in 1928 is not persuasive evidence that the property had any substantial value in 1927. He originally contracted to pay $20,000 for the lot. The receipt of one-twentieth of this sum in 1928 proves it was practically worthless prior thereto.
>
> The fact that a taxpayer recovers a small part of a loss in a subsequent year does not invalidate

it as such when its deduction in the year taken was based on the exercise of reasonable judgment from facts then known. United States v. S. S. White Dental Mfg. Company, 274 U.S. 398, 403, 47 S. Ct. 598, 71 L. Ed. 1120. Such recovery becomes a part of gross income the year of receipt. Burnett, Commissioner, v. Sanford & Brooks Company, 282 U.S. 359, 367, 51 S. Ct. 150, 75 L. Ed. 383; Cooper v. United States, 8th Cir. 9 Fed. 2d 216.

The hurricane in 1926 and its recurrence in 1927, the collapse of land speculation in Florida in 1927, the petitioner's unsuccessful effort in 1926 to sell the property continued in 1927 with the same result, and his complete abandonment and charging off of his books of the property in 1927 were identifiable events that established the loss in that year. ...

. . .

... If its amount and the year of its occurrence is factually reasonably ascertainable, it is allowable. The petitioner's claimed losses meet this test. The Board's findings are not supported by substantial evidence and its order is reversed."

In the instant case the end of the war and the change in public temper served to outmode the film "Strange Holiday" and render it worthless as shown by the wholly unsuccessful attempts to market it made by the petitioner and those in the industry to whom he turned.

B. "White Fury"

A pivotal fact here in Respondent's opinion seems to be "When a seizure of the negative in the agent's possession was threatened, the taxpayer instructed his agent to resist such action" (Resp. Br. pp. 7 and 24).

The record on the point, however, shows that his efforts to get his agent to resist were utterly worthless, and that this was properly one of the reasons for his abandoning the film in 1945. 2/

2/ "Q. Did you advise these English people not to oppose the seizure of this film by the Swedish authorities?
A. I tried to have them oppose it, but it didn't do any good.
Q. I didn't hear the answer.
A. I tried to have them oppose it, but it didn't do any good.
Q. How long did you continue to urge this opposition?
A. When the Swedish people got out an injunction and clamped down on the negative, which was in a laboratory in England, that was the end of all operations as far as the picture was concerned.
Q. The seizure did not occur until 1946.
A. The actual possession of the film perhaps was in '46 but the closing down on it, I believe, was in '45."

(R. 150-151.)

In almost the same breath, Respondent then damns Petitioner because he did not continue his efforts to recover his film (Resp. Br. pp. 24-25). We submit that Respondent cannot have it both ways: If Petitioner is to be denied a loss deduction in 1945 because he did not abandon his efforts to resist his adversary, it cannot at the same time be argued that he must be denied the loss deduction because he did not continue to exhaust all possibility of recovery (Resp. Br. pp. 24-25). Again a practical test is required. As shown by the cases cited on pages 45-47 of Petitioners' Opening Brief, none of which are even mentioned in Respondent's Brief, Petitioner here was entitled to, indeed, had to, take his loss in 1945. This is especially apparent when it is recalled that his attorney, a recognized authority in motion picture law, (Harold A. Fendler), advised him that he could not prevail in any litigation over the title to the film, that he was faced with long and expensive litigation if he contested the Swedish firm, and that the best thing to do was to abandon the project, as he had no rights (R. 100-101, 134, 140-141). Certainly under a practical test the taxpayer was well advised to rely upon the advice of his counsel.

Cahn v. Commissioner, 92 Fed. 2d 674, 676 (9th Cir. 1937)

Haywood Lumber & Mining Co. v. Commissioner, 178 Fed. 2d 769 (2nd Cir. 1950)

This is especially apparent when it is realized that if there was

any chance of prevailing against the Swedish firm, it would have been to Petitioner's advantage to litigate the matter: he had more to gain from exploiting "White Fury" than from taking a loss in connection therewith.

II.

SUMS RECEIVED FROM THE FILM "SENSATIONS OF 1945" CONSTITUTE CAPITAL GAIN RATHER THAN ORDINARY INCOME

A. Sale of a Partnership Interest

(Ref. Resp. Br. pp. 26-36.)

We are willing to let the record speak for itself as to whether a partnership or joint venture between Petitioner and Stone and Jackson is shown by his testimony pro se. We believe such is clearly shown.

We must, however, specifically dispute Respondent's contention that the record is "devoid of any definite evidence concerning a 'valuable distribution agreement' " (Resp. Br. p. 33). The record clearly shows that Petitioner, Stone and Jackson considered the distribution agreement an asset of considerable value, as, indeed, such a contract is to independent picture producers. The record contains the following:

"Q. Can you state if it ["Hi Diddle Diddle"] was released about August 20, 1943?

A. That was about the time of the release, yes, sir.

Q. It had a distribution agreement with United Artists?

A. Yes, we did.

Q. Then was this distribution agreement transferred to Andrew Stone Pictures or assigned, as we say in legal circles, in all matters except High Diddle Diddle production?

A. You mean when he formed another corporation?

Q. That is right.

A. I don't know exactly what happened after that because if you will notice from my testimony and some of the correspondence when we came to a disagreement, I had no further connection with the company and didn't know how they operated frankly, but I presume they must have turned title over to Andrew Stone Corporation." (R. 154.)

The record also shows that Petitioner personally had an element of control over or value in this distribution agreement:

"Q. Why couldn't you have been excluded from Productions by a dissolution and liquidation, which assets would have been distributed, and then a new corporation formed in which you were not a

stockholder?

A. I don't think United Artists would have been a party to that because I don't believe they would do business that way.

Q. Could you explain that.

A. The man that was the head of it was a man by the name of Edward Rafferty who was a lawyer, and I think he was a pretty honorable person, and that would have been eclipsing me, who had helped get the thing started as well as Stone." (R. 162)

* * *

"A. ... I had spent a lot of time in this project and felt it did have a future, and I had always wanted to have a United Artists release myself and was unable to get it alone. With Stone, I was able to do it.

I knew some of the officials at United Artists because years before, I had worked for them as an advertising man, and I know they were pleased to see me get into this proposition.

Then we came to a disagreement. They were anxious to see some kind of a happy settlement effected, but as I say, I could come to no terms at all with Stone, and finally we had to get his lawyer to sit down with the two people I had, and this was the agreement that

resulted." (R. 168)

During the trial the Government itself acknowledged hat the distribution agreement was of value and that Petitioner imself had a claim to it, as note the following remarks by the Government attorney:

"MR. WHITE: . . .

The fact that he [Stone] was able to obtain United Artists distribution agreement is some indication of his merit.

There is also this other item, this United Artists release, which was so valuable in which Mr. Finney apparently had some rights on. It might have been on its face an agreement between United Artists and Mr. Stone, but he apparently had some rights to this, and maybe by agreement by Andrew Stone and by Andrew Stone Productions to which Mr. Andrew Stone assigned this distribution agreement." (R. 176. See also R. 165 and 168.)

We must also directly dispute the Respondent's statement that by the agreement of September 23, 1943 (Appendix A to Pet. Op. Br.) the Petitioner "also gave up any right to future salaries" (Resp. Br. p. 35), as the testimony was categorical that Petitioner had a right to salary only for his work on the film "Hi Diddle Diddle" and not with reference to

future films. (R. 159. Respondent in effect concedes as much on the bottom of page 32 of Resp. Br.) There is, therefore, no basis for any holding or conclusion that the moneys received from "Sensations of 1945" was in lieu of a right to salary and therefore constitute ordinary income.

B. If Only Sale of Stock is Shown, Reversal Is Clearly Required

(Ref. Resp. Br. pp. 36-40.)

Respondent concedes that the Tax Court's ultimate finding "certainly is confusing and contradictory to say the least" (Resp. Br. p. 36). Respondent then speculates that "It seems more probable that the words 'do not' were inadvertently omitted following 'Sensations of 1945' in the final promulgation of this part of the Tax Court's findings and opinion" (Resp. Br. p. 37). Apart from the fact that Respondent's speculation is not convincing, we do not believe it is appropriate here. The ultimate finding remains clear and unambiguous and does not support the Tax Court's conclusion (see Pet. Op. Br. pp. 22-23).

Our position on this is fortified, we respectfully submit, by the express premise on which the Government tried the case and on which the Tax Court based its ruling; namely, that Petitioner's shares of stock could not be given a value greater than a 20% interest in "Hi Diddle Diddle". Possibly for this

reason, the Government conceded that moneys received by Petitioner from "Hi Diddle Diddle" constituted capital gain. As we have shown on pages 25-32 of Petitioners' Opening Brief, however, the theory is absolutely fallacious, though it still appears to be the Government's contention. At page 30, Respondent's Brief states:

> "No other picture had been started, and so far as the record shows, this film ["Hi Diddle Diddle"], or the proceeds to be realized from it, represented the entire value of the capital stock of Productions at the time the taxpayer purportedly sold his 20 shares to the corporation."

Apart from the above bald assertion Respondent does not attempt to uphold the theory but is simply content with the assertion that the record does not support that the theory was relevant to the Tax Court's opinion (Resp. Br. p. 39). We are content to rely on the record which is now before this Court. We have gathered in Appendix "A" hereto some of the matter from the record that shows that the Government's theory of the case, throughout, was that the value of Petitioner's stock could only be a 20% interest in "Hi Diddle Diddle". The record also shows that this was the Tax Court's belief too. (E.g. see R. 170, 172, 189-192.)

CONCLUSION

The three questions before this Court are separate and distinct and unconnected except that they all relate to Petitioner's 1945 tax return. Even Respondent has conceded the contradictory nature of the ultimate finding dealing with moneys received from "Sensations of 1945". In Petitioners' view, the case must clearly be reversed with respect to the Tax Court's determination that such moneys were ordinary income. Further in Petitioners' view, the Tax Court's determination that losses were not shown to have been sustained in 1945 with reference to the films "Strange Holiday" and "White Fury" also cannot be sustained. Petitioners therefore respectfully urge a reversal on all the specifications of error made in Petitioners' Opening Brief.

Respectfully submitted,

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APPENDIX "A"

Extracts from Record Showing Government's Theory to Be That the Value of Petitioner's Stock Could Only Be a 20% Interest in "Hi Diddle Diddle".

"Q. To try to clarify this matter, I will first ask the question generally, and then go into more figures in this agreement which is in evidence as exhibit 2.

You were a 20 per cent stockholder in Andrew Stone Productions.

A. That is right.

Q. At the time of this agreement of September 23rd, Andrew Stone Productions had no assets other than the motion picture High Diddle Diddle.

A. Correct.

Q. Had the motion picture been exhibited at that time?

A. It had not, sir.

Q. So the only value of Andrew Stone Productions, Incorporated was the value of High Diddle Diddle, subject, of course, to liabilities.

A. Yes.

Q. Pursuant to an agreement, you received a 20 per cent interest in High Diddle Diddle, in the proceeds of High Diddle Diddle. You received a 20 per cent interest.

A. I had a 20 per cent interest from the beginning.

Q. Pursuant to that agreement of September 23rd, it provided that you were to receive 20 per cent of the net profits of High Diddle Diddle.

A. Yes.

Q. In addition, it provided that you were to receive 12 per cent of three additional pictures which may be made by Andrew Stone and Frederick Jackson.

A. Yes, sir.

Q. In addition, you were to receive certain lump sums from each picture.

A. Yes, sir.

Q. I think the Court asked yesterday, why, if all you had was a 20 per cent interest in Andrew Stone Productions, were they willing to give you these percentages and lump sums over the 20 per cent of High Diddle Diddle?" (R. T. p. 160, l. 3 - p. 161, l. 12.)

* * *

"MR. WHITE: Your Honor, to clarify it a little, I think what happens is that Productions is dissolved and all it had to distribute to its stockholders was an interest in the proceeds of High Diddle Diddle." (R. T. p. 165, l. 2 - l. 5.)

* * *

"THE COURT: What is the Government's theory of treating this as ordinary income?

MR. WHITE: The Government's theory is that he didn't sell stock; that he sold other things as well as income, such as rights to salary, other rights that he may have had against these individuals.

THE COURT: Any theory that these payments might have been dividends?

MR. WHITE: Not so restricted to dividends. Primarily as sole rights or future rights to income from any productions by Mr. Andrew Stone and through United Artists release."
(R. T. p. 175, l. 22 - p. 176, l. 7.)

* * *

"MR. WHITE: Mr. Finney, maybe I can add a few remarks that would help you to understand my difficulty and presume that I am trying to read the Judge's mind as to what is in general law.

Under general law and I believe I can state this as California law, stockholders who control the corporation through 80 per cent of the voting can dissolve and liquidate. Now that 20 per cent stockholder can't stop them. They have got a right to do that.

Andrew Stone held 60 per cent and Mr. Jackson held 20. I believe it is true in California law that all you need is more than 50 per cent, so Andrew Stone alone could have liquidated it and dissolved the corporation. If he had done so,

the only asset distributed was High Diddle Diddle or the net proceeds from reproduction or exhibition of High Diddle Diddle, which means that you could have received no more than 20 per cent of the net proceeds of High Diddle Diddle.

BY MR. WHITE:

Q. Mr. Stone, I think you would agree, was represented by a counsel and probably Mr. Jackson was. Nevertheless, they entered into an agreement whereby for your 20 per cent, they gave you not only 20 per cent interest in the net proceeds of High Diddle Diddle but lump sums for three more pictures and a 12 per cent interest in these three additional pictures.

For what conceivable reason would they do that? Your stock wasn't worth that much. Your stock would only be worth 20 per cent of the net proceeds of High Diddle Diddle. I can speculate as to why they did so on the additional sums. Maybe you are relinquishing some other right." (R. T. p. 178, l. 14 - p. 179, l. 15.)

* * *